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Witness: Brad P. Beecher
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Sponsoring Party: Empire District Electric
Case No.: ER-2016-0023
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Before the Public Service Commission
of the State of Missouri

Rebuttal Testimony

of

Brad P. Beecher

April 2016

SERVICES YOU COUNT ON

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OF
BRAD P. BEECHER
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2016-0023

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REBUTTAL TESTIMONY
OF
BRAD P. BEECHER
THE EMPIRE DISTRICT ELECTRIC COMPANY
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INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Brad P. Beecher, and my business address is 602 S. Joplin Avenue, Joplin, Missouri, 64801.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. The Empire District Electric Company ("Empire" or "Company") is my employer. I hold the position of President and Chief Executive Officer.

Q. ARE YOU THE SAME BRAD BEECHER THAT FILED DIRECT TESTIMONY IN THIS CASE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I will respond to the positions taken by the Staff of the Missouri Public Service Commission (“Staff”) and the Office of the Public Counsel (“OPC”) concerning Empire’s incentive compensation. I will also address that portion of the Staff’s adjustment to payroll related to Empire’s pending merger with Algonquin Utilities. In addition, I will respond to the Staff and OPC positions on Empire’s Supplemental Executive Retirement Plan (“SERP”).

<u>INCENTIVE COMPENSATION</u>

Q. HOW IS THE EXECUTIVE COMPENSATION PROGRAM AT EMPIRE DESIGNED?

A. Empire's executive compensation is determined and administered by the Compensation Committee of Empire's Board of Directors. The Compensation Committee is made up of five non-employee, independent Empire Board members. Empire's executive compensation program is designed to provide a competitive compensation package that will enable the Company to attract and retain highly talented individuals for key positions and promote the accomplishment of Empire's performance objectives. Empire's compensation objective is for the program's structure to be consistent with our industry peers, while providing compensation which is conservative when compared to the same peer group.

Q. HOW IS EMPIRE'S COMPENSATION PROGRAM STRUCTURED?

A. Empire's compensation program utilizes a base salary coupled with incentive programs that link compensation to individual and Company performance factors. Empire targets total compensation (base pay and incentive pay) at the 25th percentile of a comparable industry-specific peer group. As explained below, the appropriate total compensation amount is determined and then a certain portion of the compensation package is put at risk.

Empire's executive compensation program includes three basic compensation elements: (1) base salary; (2) annual (short-term) cash incentives based on threshold (minimum expected), target, and maximum performance measures; and, (3) long-term incentives.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY 25TH PERCENTILE.

A. In essence, if there were 100 employees with the lowest paid employee ranked number 1 and the highest paid employee ranked number 100, then the Empire employee would be targeted at number 25.

Q. WHAT PROCESS DOES THE COMPENSATION COMMITTEE USE TO ESTABLISH COMPENSATION?

A. The Compensation Committee retains an independent third-party consultant to provide guidance on best practices within executive compensation as well as to provide recommendations for the establishment of a peer group and compensation levels.

Q. HOW DOES EMPIRE'S COMPENSATION APPROACH COMPARE TO SIMILAR COMPANIES?

A. Empire's approach is comparable, by incorporating a mix of base salary, short-term incentives, and long-term incentives into a total executive compensation package. This reflects a "best practices" approach used by companies both inside and outside the utility industry. Rather than relying solely on fixed compensation in the form of base salary, this best practices approach also includes a considerable measure of variable **(at risk)** compensation in the total compensation package. This approach aligns employee performance with the interests of customers and shareholders.

Q. AS YOU UNDERSTAND IT, HOW DOES EMPIRE'S EXECUTIVE COMPENSATION PHILOSOPHY COMPARE WITH THE COMPENSATION PHILOSOPHY OF OTHER COMPANIES?

A. Based on my previous reading of other proxies in our industry specific peer group, nearly all utilize a mix of base salary, annual incentives, and long-term incentives much like utilized by Empire, but Empire's approach is more conservative. The

Compensation Committee has targeted the total compensation at the 25th percentile of the industry specific peer group rather than the more commonly used 50th percentile.

Q. WHAT ADJUSTMENT IS STAFF PROPOSING TO PAYROLL LEVELS FOR INCENTIVE AND EXECUTIVE COMPENSATION?

A. Despite the fact that Empire's overall compensation philosophy is conservative compared to Empire's peer group, Staff still recommends the removal of several components of Empire's total compensation package from test year expense, namely those that constitute the variable, equity, or at risk portions of compensation. In addition to a specific elimination of executive equity incentive compensation, the Staff is recommending removal of 20.72 percent of the compensation associated with the Management Incentive Compensation Plan ("MIP") for senior officers and department heads and 100 percent of Empire's Lightning Bolts awards. These adjustments are discussed in the Staff Revenue Requirement Report at pages 98-100.

Q. HOW DO YOU CHARACTERIZE THESE STAFF ADJUSTMENTS TO COMPENSATION?

A. They are unreasonable.

Q. WHY?

A. Total target compensation for Empire is at the 25^{th} percentile of a comparable industry peer group. Our program is designed with consideration of best industry practices and as such, the cash incentive (at risk) compensation expense associated with the performance measures discussed above should be included in cost of service.

No cash incentive awards are payable to an executive officer unless performance is above the threshold, or minimum, level of expected performance as approved by the Compensation Committee.

Q. WHAT ADJUSTMENT DID STAFF MAKE RELATED TO EQUITY COMPENSATION?

A. Staff recommends removal of the full amounts of the equity compensation (performance-based and time-based restricted stock) associated with the long-term incentive award.

Q. DO YOU AGREE WITH THE STAFF'S RECOMMENDATION TO REMOVE SUCH FORMS OF VARIABLE OR AT-RISK COMPENSATION FROM TEST YEAR EXPENSE?

A. No. In essence, the elimination of the variable or at-risk compensation by the Staff incorrectly assumes such awards are **not part of reasonable and prudent total compensation**, but instead, are **in addition to reasonable and prudent total compensation levels** developed by Empire's Compensation Committee, and therefore constitute an incremental compensation benefit that has no corresponding benefit for Empire's customers. This is simply an incorrect premise.

Q. PLEASE EXPLAIN.

A. Each component of Empire's variable compensation is essential to complete the executive's reasonable and prudent total compensation package. Variable compensation is "at risk", and standards, in the form of performance criteria, are necessary in order to determine what portion of the compensation is earned. The Compensation Committee has developed such performance criteria as a function of placing a substantial portion of an executive's total compensation in variable rather than fixed vehicles in order to encourage high levels of employee performance. This approach is consistent with the approach utilized by Empire's peer group companies and the utility industry in general.

Q. WHAT WOULD BE THE CONSEQUENCE OF FOLLOWING STAFF'S RECOMMENDED ADJUSTMENTS TO EXECUTIVE COMPENSATION?

A. Staff's position undermines the overall objectives of Empire's Compensation Committee by shifting the emphasis away from employee performance and incentivizing the use of base compensation to ensure cost recovery through rates. The Compensation Committee could design an executive compensation program that includes ***all*** compensation in base salary in an attempt to circumvent the removal of at-risk pay from the cost of service. However, the Compensation Committee does not believe such a compensation design approach would best serve our customers or Empire's shareholders as well as the compensation program Empire currently has in place.

Q. HOW DOES EMPIRE'S BOARD USE THE COMPENSATION PROGRAM TO INFLUENCE MANAGEMENT OF THE COMPANY?

A. Consistent with the Compensation Committee's philosophy, which I discussed earlier, each executive's total compensation package includes a considerable level of variable or at risk compensation. As such, it is necessary for the Compensation Committee to establish a set of performance criteria, to determine what portion of variable pay is actually earned. The performance criteria for each executive are tied to the Company's vision and goals established at the beginning of each performance year. These performance criteria form the core of each executive's responsibility and are not simply accomplishments that are above regular job duties. Accomplishment of these criteria has a significant and positive impact on the operational and financial condition of the Company, which ultimately accrue to the benefit of the customer. Conversely, non-accomplishment of such performance criteria has a negative impact on the Company. The degree, or lack thereof, of accomplishment is reflected in the variable nature of the associated compensation award.

Q. DOES THE STAFF RECOMMENDATION RECOGNIZE THIS FUNCTION?

A. No. The Staff's recommended adjustment, which removes variable compensation for executives from the test year expense, does not recognize the compensation awarded each executive for accomplishment of the core responsibilities of his or her position and the benefits those accomplishments bring to Empire and its electric customers. Staff makes no allegations of imprudence with regard to the total (base + at-risk) executive compensation, but simply arbitrarily removes a portion of total compensation. This example is illustrative of why achieving allowed ROE's in Missouri is challenging. All elements of executive compensation should properly be included in test year expense.

Q. HOW DOES EMPIRE APPROACH COMPENSATION WHEN IT INVOLVES ITS NON-EXECUTIVE SALARIED EMPLOYEES, AND HOW DOES THAT APPROACH COMPARE WITH BEST PRACTICES?

A. As with compensation for executive employees, Empire follows best practices in its compensation structure for non-executive salaried employees by linking the Company's performance management systems with how employees are paid. This is achieved by allocating a percentage, or fixed amount, of an employee's compensation to a variable pay program tied directly to the attainment of goals and objectives set forth by management and aligned with Empire's overall vision, goals and key business strategies. These goals and objectives are above the regularly expected results of the non-executive salaried employee's position, and, when achieved, add benefit to the Company's customers.

Q. DID THE STAFF PROPOSE ADJUSTMENTS TO NON-EXECUTIVE SALARIED COMPENSATION EXPENSE FOR THE TEST YEAR?

A. Yes. The Staff excluded a portion of incentive compensation for non-executives that was associated with goals that the Staff believed benefited shareholders and not customers. Again, the Staff made no allegations of or provided any evidence of imprudent behavior. The Staff's approach in this area was much like its position with respect to executive compensation and marks another reason achieving authorized ROEs is difficult in Missouri.

Q. DOES THE STAFF RECOMMEND ADJUSTMENTS TO ANY OTHER FORM OF COMPENSATION?

A. Yes. The Staff recommends removal of the Lightning Bolt program costs from test year expense. Again, the Staff makes no allegation of or provided any evidence of imprudence. Staff recommends disallowance of the entire amount of compensation awarded through the program during the test year and yet again marks another reason that achieving authorized ROEs is difficult.

Q. PLEASE EXPLAIN THE LIGHTNING BOLT PROGRAM.

A. The Lightning Bolt program is not an incentive program, but a reward program for salaried employees who went above and beyond their duties and work hours, but who do not earn overtime. During the test year 15 non-executive employees were recognized with a total of $24,750, representing an average lightning bolt for this small group of $1,650. Through this program, Empire provides cash awards to individuals who deliver results beyond those normally associated with their position, often involving protracted time beyond normal work hours spent on special projects. In no way does the Lightning Bolt program fully compensate the non-executive salaried individual for the additional effort they put forth. However, it is a vehicle available to the Company to compensate and show appreciation to salaried individuals who do not earn overtime for working beyond their normal hours during prolonged projects. Payments made under the Lightning Bolt program are closely related to Empire's cost of service and should properly be included in test year expense.

Q. DID THE OPC PROPOSE EXCLUSIONS IN INCENTIVE AND VARIABLE PAY SIMILAR TO THOSE BEING PROPOSED BY STAFF IN THIS CASE?

A. Yes, although OPC's recommendations in this area appear to be even more extreme than Staff's. OPC witness Hyneman, at pages 18 through 25 of his direct testimony, indicates the OPC's opposition to including any incentive or variable compensation in Empire's Missouri revenue requirement.

Q. DO YOU AGREE WITH THE OPC'S POSITION ON EMPIRE'S INCENTIVE AND VARIABLE COMPENSATION?

A. No. For the same reasons I mentioned earlier related to the Staff payroll adjustments for variable pay, I do not agree with OPC's recommendations in this area. OPC makes no allegations of imprudence and provides no evidence to support its position that Empire's compensation is not a proper expense. As such, OPC's position is unreasonable.

ALLOCATION OF PAYROLL COSTS

Q. DOES THE STAFF ADJUSTMENT TO PAYROLL INCLUDE A COMPONENT RELATED TO EMPIRE'S OTHER ACTIVITIES, AND IN PARTICULAR THE PENDING MERGER WITH ALGONQUIN UTILITIES?

A. Yes. It appears the Staff adjustment reducing the level of electric payroll included in the Staff Missouri jurisdictional revenue requirement includes an arbitrary reduction of approximately $175,000 related to Empire's pending merger with Algonquin Utilities.

Q. DO YOU AGREE WITH THIS ADJUSTMENT?

A. No.

Q. WHY?

A. I disagree with this adjustment for several reasons. The pending merger is an isolated event. The merger does not represent an ongoing activity for Empire, and should not be reflected in the ongoing rates Empire charges for electric service. Second, the only individuals involved in this activity during the test-year are salaried, and Empire has not incurred any incremental payroll costs during the test year as a result of the merger. There is no additional payroll cost related to the merger included in Empire's as-filed rate case. Incremental costs associated with the merger, such as travel expenses, are being captured by Empire and recorded in a separate account to ensure that they do not directly impact our requested revenue requirement. None of these costs have been included in Empire's revenue requirement in this case. Third, in addition to this being an isolated event, the Staff's ongoing payroll costs included in Empire's revenue requirement already exclude significant amounts of executive pay for what Staff has defined as shareholder activities. At the very least, the Staff's proposed merger adjustment would represent a double disallowance for this activity. Furthermore, as I understand it, the Staff's payroll adjustment includes an electric expense allocation ratio that excludes even more payroll from Empire's ongoing electric revenue requirement. Empire witness Bryan Owens will discuss the Staff's electric allocation of ongoing payroll costs in his rebuttal testimony in this case. Empire witness Scott Keith will also address the Staff's proposed allocation of common corporate costs in his rebuttal testimony in this case.

SUPPLEMENTAL EXECUTIVE RETIREMENT PROGRAM

Q. PLEASE GENERALLY DESCRIBE EMPIRE'S SUPPLEMENTAL EXECUTIVE RETIREMENT PROGRAM ("SERP").

A. Empire's SERP program is designed as part of Empire's overall executive compensation package, and it is designed to restore the retirement benefits not covered by the executives due to the cap on compensation required by ERISA that is included in Empire's pension program. SERP costs are expensed as they are paid and are not sourced from the pension fund.

Q. DO YOU AGREE WITH THE EXCLUSIONS TO EMPIRE'S SERP COSTS TAKEN BY STAFF AND OPC IN THIS CASE?

A. No. The positions taken by Staff and OPC understate the ongoing costs associated with Empire's SERP in Empire's electric revenue requirement.

Q. HOW HAS THE POSITION TAKEN BY STAFF UNDERSTATED THE LEVEL OF ONGOING SERP COSTS?

A. Staff has used a five-year average of the SERP benefits actually paid by Empire to arrive at an ongoing level of SERP costs for rate purposes (See Staff Report Revenue Requirement pages 103-104). The use of a five-year average of actual benefits paid will understate the ongoing level of Empire's SERP payments, since additional Empire executives have entered the program in the last few years. A five-year average will reduce the annual impact that the recent retirements have had on Empire's SERP costs and understate the ongoing SERP payments that Empire is currently making. More specifically, Empire currently makes SERP payments to seven past executives, including one executive that retired in late 2014 and one executive that retired in late 2015. In total, the annualized level of total SERP payments is almost $372,000. The Staff annualized level using a five year average is almost $306,000. The Staff starting point for SERP payments is $66,000 lower than Empire is currently paying and marks yet another reason it is difficult to achieve authorized ROEs in Missouri.

Q DO YOU AGREE WITH OPC'S POSITION ON EMPIRE'S ONGOING SERP COSTS?

A. No. OPC witness Hyneman has arbitrarily limited Empire's SERP payments to $20,000 per participant or a starting point of $140,000. At page 16 of his direct testimony, Mr. Hyneman makes a brief reference to a review he made of SERP payments made by other Missouri electric utilities as support for his recommendation. We have requested access to this analysis from Mr. Hyneman, but at the date of this testimony it has not been provided. In any event, the level of SERP payments recommended by OPC is unreasonable and is well below the level of SERP payments being made by Empire at this time, and should be rejected by the Commission.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY AT THIS TIME?

A. Yes, it does.

AFFIDAVIT OF BRAD P. BEECHER

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 26th day of April, 2016, before me appeared Brad P. Beecher, to me personally known, who, being by me first duly sworn, states that he is the President and CEO of The Empire District Electric Company and acknowledged that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.

Brad P. Beecher
Brad P. Beecher

Subscribed and sworn to before me this 26th day of April, 2016

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JANET L. HUNLEY
My Commission Expires
September 20, 2019
Jasper County
Commission #15243846

Janet L. Hunley
Notary Public

My commission expires: September 20, 2019.